Supreme Court, U.S.
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No. 95-909

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1995

KOCH OIL COMPANY,
Petitioner,
v.
COMMITTEE OF CREDITORS
HOLDING UNSECURED CLAIMS,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Did the Ninth Circuit (following an opinion of the Fourth Circuit) correctly hold that a debtor's preferential payment to a creditor is voidable under Bankruptcy Code Section 547(b) where the creditor received more than it would have under a Chapter 7 distribution?

2. In rendering its opinion, did the Ninth Circuit (as had the Fourth Circuit) properly refuse to consider whether the creditor could benefit from a preferential payment merely because, absent the preference, the creditor would have received payment from a third party?

RULE 29 STATEMENT

Respondent Committee of Creditors Holding Unsecured Claims has no parent company, subsidiaries or affiliates that have issued shares to the public.

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OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent Committee of Creditors Holding Unsecured Claims ("Committee") respectfully submits this opposition to Petitioner Koch Oil Company's ("Koch") Petition for Writ of Certiorari.

COUNTERSTATEMENT OF THE CASE

A. Prefatory Statement

In this matter, the Ninth Circuit, demonstrating absolute consistency among the federal courts which have considered the issue, held that a debtor's payment of $3,209,425.81 to Koch less than ninety days before the debtor's bankruptcy filing might be a voidable preference under Section 547(b) of the Bankruptcy Code.[1] Consistent with both statutory language and prior case law, the Ninth Circuit held that, in determining whether a creditor received more from an allegedly preferential payment than that creditor would have received under a Chapter 7 distribution, a court does not consider the creditor's ability to recover payments from a third party. Essentially, the Ninth Circuit's decision reaffirms the unremarkable principle that a creditor should not receive through preferential payments more than it would have received from a Chapter 7 distribution.

Given the clear language of Section 547(b) and the absence of any conflict in the law, this case does not warrant review by this Court. Nonetheless, Koch maintains that, instead of examining whether the allegedly voidable preference resulted in it receiving *more* than it would have received under a Chapter 7 distribution, the correct analysis should be whether the alleged preference resulted in other creditors actually receiving *less* under a Chapter 7 distribution. Koch cites no valid authority for its novel position, and certainly cannot raise an issue meriting this Court's review. Quite simply, the plain language of section 547(b)(5) voids transfers when the creditor received more from the transfer than it would have received under a Chapter 7 distribution.

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[1] The Ninth Circuit remanded the matter to the bankruptcy court to determine what portion, if any, of the $3,209,425.81 is protected from avoidance by Section 547(c)(1) of the Bankruptcy Code. All references to the Bankruptcy Code are to Title 11 of the U.S. Code.

Koch also asserts that the Ninth Circuit's interpretation of Section 547(b) poses a threat to the commercial use of letters of credit. Not only is this assertion completely speculative, but a leading scholar on letters of credit anticipated the Ninth Circuit's decision a number of years ago, offering language for incorporation into letters of credit which would protect parties like Koch.[2] Koch's attempt to create a crisis cannot transform this case into one meriting this Court's review.

B. Statement of Facts

In the early 1980s, the debtor, Powerine Oil Company ("Powerine"), engaged in oil refining. In the course of that business, Powerine entered into a series of note agreements with a number of insurance companies, which collectively loaned Powerine $21,000,000. Later, several banks agreed to lend Powerine up to $229,600,000. As an inducement to the banks to make their loans and to the insurance companies (collectively with the banks, the "Secured Lenders") to waive certain restrictions in their note agreements, Powerine entered into a security agreement with a trustee for the Secured Lenders, whereby Powerine assigned to the trustee a blanket lien in Powerine's assets, including all accounts, equipment, fixtures, inventory, and general intangibles, which in turn included Powerine's bank accounts.

From 1982 until it filed for bankruptcy protection on March 26, 1984, Powerine entered into contracts to buy crude oil from Koch. Powerine's obligations to Koch were buttressed by two letters of credit in favor of Koch. Within ninety days before Powerine filed for bankruptcy, the preference period, Koch billed Powerine three times, for deliveries in December 1983, January 1984, and February 1984.

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[2]The very same literature, albeit a different section of that literature, is cited in both the petition and the amicus brief.

Powerine paid Koch $8,550,900.70 for the deliveries in December and January. However, Powerine failed to pay Koch for the February deliveries, and Koch drew on the letters of credit.

As of the date of its bankruptcy filing, Powerine owed its Secured Lenders approximately $282,000,000, including contingent liabilities for letters of credit that had been issued on its behalf. At that time Powerine's assets were worth approximately $66,000,000. Of the $8,550,900.70 paid to Koch during the preference period, $3,209,425.81 was paid more than 45 days after the oil was actually delivered to Powerine. Following confirmation of Powerine's plan of reorganization, the Committee commenced this action against Koch, challenging the preference period payments as voidable transfers under the Bankruptcy Code.[3]

In September 1989, the Bankruptcy Court for the Central District of California ("Bankruptcy Court") heard cross-motions for summary judgment in this action. The Bankruptcy Court granted Koch's cross-motion for summary judgment, finding that 11 U.S.C. Section 547(c)(1) protected the transfers to Koch from avoidance under the Bankruptcy Code. The Committee properly appealed that judgment to the Bankruptcy Appellate Panel for the Ninth Circuit ("BAP"). In July, 1992, the BAP affirmed the judgment of the Bankruptcy Court, although it did not affirm it under 11 U.S.C. Section 547(c), but rather under 11 U.S.C. Section 547(b)(5). The Committee timely appealed that BAP's order to the Ninth Circuit.

The Ninth Circuit determined that the $3,209,425.81 paid to Koch more than 45 days after the oil was delivered

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[3]Under the plan, the Committee was designated the representative of the estate to pursue the claim. The amended plan provides that any recovery on the claim will be divided between the Secured Lenders and the unsecured creditors of the Powerine estate.

was preferential under Section 547(b) of the Bankruptcy Code. The Ninth Circuit concluded, however, that Bankruptcy Code Section 547(c)(1) might shield some of that payment from avoidance to the extent that a corresponding contingent secured claim against Powerine was also released. The Ninth Circuit remanded the matter to the Bankruptcy Court for determination of that issue.

REASONS FOR DENYING KOCH'S PETITION FOR WRIT OF CERTIORARI

I.

The Bankruptcy Code's preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. *Union Bank v. Wolas*, 502 U.S. 151, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991). Any creditor that receives a greater payment than others of its class is forced to disgorge so that all may share equally. *Id.* at p. 157. Section 547(b) empowers the trustee to restore equal status to all creditors by voiding any transfer by the debtor to a creditor made during the preference period that results in that creditor receiving more than it would under a hypothetical Chapter 7 distribution of the debtor's estate. *Id.* at p. 151; *Alvarado v. Walsh (In re LCO Enterprises)*, 12 F.3d 938 (9th Cir. 1993).[4] Put differently, Section 547(b) requires an inquiry into whether a creditor receives a greater percentage of its claims than it would have

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[4]Section 547(b), which contains provisions sometimes referred to as the "greater amount" test, requires the court to construct a hypothetical Chapter 7 case and determine what the creditor would have received if the case had proceeded under Chapter 7. *In re Ehring*, 900 F.2d 184, 188 (9th Cir. 1990); *In re Lewis W. Shurtleb*, 778 F.2d 1416, 1420-22 (9th Cir. 1986).

received in its "distributive share" from a Chapter 7 liquidation.[5]

Applying the plain language of Section 547(b), the Ninth Circuit held that Powerine's payment to Koch during the preference period was voidable because Koch unquestionably received more of the $3,209,425.81 than it would have received under a Chapter 7 distribution.[6]

The Ninth Circuit did not apply the test that Koch presses here, namely that in calculating what a creditor would have received under a Chapter 7 distribution, a court should consider the creditor's ability to obtain payments from third parties absent the preferential payments. In this regard, the Court of Appeals' decision is consistent with *In re Virginia-Carolina Financial Corp.*, 954 F.2d 193 (4th Cir. 1992), where a Chapter 7 trustee sued a creditor on the

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[5]The House Report on Section 547(b) states:

> "The transfer must enable the creditor to or for whose benefit it was made to receive a greater percentage of his claim than he would receive under the distributive provisions of the bankruptcy code. Specifically, the creditor must receive more than he would if the case were a liquidation case, if the transfer had not been made, and if the creditor received payment of the debt to the extent provided by the provisions of the code."

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. (1977) at p. 372. Commentators on this Report make clear that this test is what the creditor would receive under the "distributive provisions" of the Bankruptcy Code. Herzog and King, *Collier Pamphlet Edition Bankruptcy Code Part 1*, p. 442 (Matthew Bender 1993).

[6]In fact, as an unsecured creditor, Koch would have received nothing in a Chapter 7 distribution, since there was a general lien in favor of the Secured Lenders, whose claims far exceeded the value of all Powerine's assets. *See Deel Rent-A-Car, Inc. v. Levine*, 721 F.2d 750 (11th Cir. 1983).

ground that a payment on a loan made before the bankruptcy was a voidable preference. The Fourth Circuit held:

> "As the plain language of Section 547(b)(5) conveys, the court must focus, not on whether a creditor may have recovered all the monies owed by the debtor from any source whatsoever but instead upon whether the creditor would have received less than a 100% payout in a Chapter 7 liquidation."

Id. at p. 199 (citing Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 Vand. L. Rev. 713, 735-37 (1985)): *Accord, In re Formed Tubes, Inc.*, 41 B.R. 819, 821 (Bankr. E.D. Mich. 1984) (stating, in relevant part, that the only relationship that is crucial to a preference section is the creditor's relationship to the debtor). This reasoning is also consistent with the recent decision of the bankruptcy court in *Krafsur v. Scurlock Permian Corp. (In Re El Paso Refinery, Ltd. Partnership)*, 178 B.R. 426 (Bankr. W.D. Tex. 1995).[7] That case, like this case, involves alleged preferential payments to an oil company, who was also the beneficiary under certain letters of credit. *Id.* at pp. 430-431. In applying the test of Section 547(b)(5), and concluding that a portion of the alleged preferential transfer was voidable, the court expressly noted that:

> "A trustee need only prove that, as a result of the transfer, the creditor received a greater percentage recovery on its debt than it would otherwise have received had it looked *solely to distribution from the Chapter 7 estate for its payment.*"

Id. at p. 433 (Emphasis supplied).

In re Virginia-Carolina Financial Corp., *In re Formed Tubes* and *In re El Paso Refinery, Ltd. Partnership* are the

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[7] Currently on appeal to the United States District Court for the Western District of Texas.

only other cases the Committee is aware of which address this issue. So, the Ninth Circuit's decision follows the letter of the statute and is in complete accord with the only other courts considering similar issues. For that reason, Koch's petition should be denied.

II.

In seeking to justify review, Koch makes two additional arguments, neither of which support its request for review. Koch first asserts that, in conducting an analysis under Section 547(b), "a court must determine whether the transfer alleged to be preferential reduced the amount an unsecured creditor would have received by a hypothetical Chapter 7 liquidation under a hypothetical alternative set of facts." (Petition, at p. 12.) In other words, according to Koch, if, absent the preference, the other creditors would have received the same amount, then the preference is not voidable. In support of this argument, Koch cites *Continental & Commercial Trust & Savings Bank v. Chicago Title & Trust Co.*, 229 U.S. 435, 444, 33 S.Ct. 829, 57 L.Ed. 1268 (1913); *New York County National Bank v. Massey*, 192 U.S. 138, 147, 24 S.Ct. 199, 48 L.Ed. 380 (1904); and *Virginia National Bank v. Woodson*, 329 F.2d 836, 840 (4th Cir. 1964). Koch's contention is unsupportable.

Significantly, *Continental, Massey* and *Woodson* do not address Section 547 at all. Instead, these cases concern the so-called "diminution of the estate" doctrine of the prior Bankruptcy Act of 1898. That doctrine supposedly requires a court in a preference action to examine what other unsecured creditors of Powerine would receive under a Chapter 7 distribution. But, putting aside the inapplicability of that doctrine to current law, not even the Bankruptcy Act of 1898 contained any explicit "diminution of the estate" doctrine. *See Deel Rent-A-Car, Inc. v. Levine*, 721 F.2d 750,

755 (11th Cir. 1983). The cases on which Koch relies do not support Koch's assertions here.

In *Continental and Commercial Trust and Savings Bank v. Chicago Title and Trust, supra,* decided under the prior Bankruptcy Act, a debtor who was a member of the Chicago Board of Trade had held certain margin certificates representing the security deposits that he had made with other traders. During the preference period, the debtor relinquished any claim to the certificates as part of an arrangement to satisfy various debtors. When the trustee attempted to avoid the transfer of the certificates as a preference, this Court found:

> "What was done did not in fact diminish the estate of Prince [the debtor], otherwise available to the creditors in the bankruptcy proceeding, for the traders holding them would have had the benefit of the deposits under the terms of the certificates and the rules of the Board of Trade." 229 U.S. at pp. 443-44.

In other words, "the creditors of the [debtor's] estate had no claim on the margin certificates." *Deel Rent-A-Car,* at p. 756 (discussing the *Continental and Commercial Trust* case at length). That is, since the property transferred was not the property of the debtor's estate, there could be no preference. Here, there clearly was a transfer of Powerine's property to Koch (Powerine paid $3,209,425.81 to Koch).

In *New York County National Bank v. Massey, supra,* this Court, again under the prior Bankruptcy Act, reconciled preference law with a bank's "right of set-off recognized and enforced in law" over a bank deposit, stating:

> "one's credit in a bank does not operate to diminish the estate of the depositor, for when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the amount of the deposit . . ." *Id.* at p. 147.

Since this Court found that a deposit was "not a transfer of property as a payment, mortgage, gift or security," the deposit could not be a preference. *Id.* Again, here, Powerine clearly transferred money to Koch.

In *Virginia National Bank v. Woodson*, the debtor's sister paid $8,000 within the preference period to a creditor of the debtor. The *Woodson* court held that the payment could not be a voidable preference, since the payment had not been property of the debtor's estate and thus could not have diminished the bankruptcy estate. *Id.* at p. 839. However, the *Woodson* court also found that the transfer of certain rights to a swimming pool, which had been transferred from the debtor to his sister as part of the payment to the creditor, could be a voidable preference. *Id.* In stark contrast to this case, *Woodson* — like the other cases on which Koch relies — involved no transfer of the debtor property to the creditor.

Koch's interpretation of Section 547 would stand Section 547(b)(5) on its head. Instead of focusing on what Koch would have received under a Chapter 7 distribution, Koch would inquire into what Powerine's other unsecured creditors would receive under a Chapter 7 distribution, irrespective of whether Koch received a preference. Such an approach is justified neither by the statutory language nor the case law.

III.

Finally, Koch and Amicus Curiae assert that the Ninth Circuit's decision "will mark the end of the usefulness of the standby letter of credit." Koch claims that "prior to the ruling of the Court of Appeals in this case, standby letters of credit gave creditors confidence that they would receive a nonpreferential payment, even from an insolvent debtor." (Petition, at p. 20). Koch asserts, without authority, that

such creditors will now lose confidence in letters of credit. The argument is without merit.

First, as an empirical matter, Koch has nowhere presented facts to support its assertion. Second, the argument that the Ninth Circuit's opinion somehow frustrated commercial expectations lacks merit. As early as 1991, a leading commentator on letters of credit noted that an insolvent debtor's payment to a beneficiary under a letter of credit could be a preference. *See*, *Dolan*, The Law of Letters of Credit, ¶ 7.03(3)(e) (2d Ed. 1991). Dolan even suggested a drafting alternative that would avoid such a result. *Id.*[8] Thus, contrary to Koch's dire prediction, the Ninth Circuit's opinion was anticipated in the literature, and any hypothetical issues arising from the opinion can be — and indeed, given the dearth of reported case law, may have been in many cases alleviated by simple drafting.[9]

Disregarding that drafting option, the Amicus Curiae asserts that the Ninth Circuit's decision "upsets the reasonable expectations of letter of credit beneficiaries" (Brief of Amicus Curiae, at p. 11) and "creates an unwarranted exception to the 'independence' principle provided in domestic and international letters of credit" (*Id.* at p. 3.) In

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[8]Specifically, Dolan stated:

> "If the account party pays the note, there will be no draw on the credit, which may expire by its terms. If the account party becomes bankrupt, and if the payment occurs during the preference period, the trustee may be able to set the payment aside. At that point, the beneficiary will have to surrender the payment it received and will not be able to draw on the expired credit. A beneficiary that doubts the account party's solvency will insist that the credit not expire for a sufficient period of time after payment and that it be payable against documents certifying the existence of bankruptcy proceedings."

[9]Undoubtedly the market has already internalized the cost of such revisions to the terms of these types of letters of credit.

support of this assertion, the Amicus Curiae cite *Alaska Textile Co. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813 (2d Cir. 1992); *American Bank & Leasing Service Co. (In Re Air Conditioning)*, 845 F.2d 293 (11th Cir. 1988); and *Kellogg v. Blue Quail Energy, Inc. (In Re Matter of Compton Corp.)*, 831 F.2d 586 (5th Cir. 1987).

The reliance on the "independence" principle and these cases are misplaced. Under the "independence" principle, an issuer's obligation to a letter of credit's beneficiary is independent from any obligation between the beneficiary and the issuer's customer. *Kellogg*, at p. 589. However, that principle has no relevance to this case, since this case did not involve the actual payment under a letter of credit. To the contrary, because Koch received a payment (albeit a preferential payment) from the debtor, no obligation to pay under the letters of credit even arose, and the issuer never had to examine the customer/beneficiary obligation. The letters, like many in commercial law, merely expired by their terms.[10]

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[10]The cases cited by the Amicus Curiae do not support its conclusion. *Alaska Textile Co.* did not even involve a bankruptcy proceeding, but instead concerned the narrow issue of a bank's duties under the Uniform Customs and Practices for Document Credits when a beneficiary under a letter of credit presents documents for payment to the bank "on an approval basis." *Id.* 982 F.2d at p. 814. In *American Bank & Leasing Service Co.*, the court merely affirmed a judgment holding that a payment made pursuant to a letter of credit was a preference, after finding unpersuasive the creditor's "waving a banner acclaiming inviolability of letters of credit" as a defense to Section 547(b). 845 F.2d at 296. *Finally, Kellogg v. Blue Quail Energy* concluded that the transfer at issue was a preference. 831 F.2d at p. 589. Nothing in these cases transforms this case into one meeting the standards for this Court's review.

CONCLUSION

For all the above reasons, Koch's Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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